The Real Secrets of the Temple

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The Federal Reserve—the U.S. government's central bank—was schemed at a secret meeting in 1910 at J. P. Morgan's hunting club on Jekyll Island, Georgia.

The participants—who claimed, as they boarded a private railroad car in New York City, to be going on a hunting trip—were, in addition to Morgan himself: Senator Nelson W. Aldrich (R-RI), John D. Rockefeller's son-in-law; A. Piatt Andrew, Assistant Secretary of the Treasury in the Taft administration; Henry P. Davison, the "political partner" (i.e., lobbyist) for J. P. Morgan's banking house; Paul Warburg of Kuhn Loeb & Co., a German political partner brought to the U.S. specifically to help establish a central bank; and Frank A. Vanderlip of New York's National City Bank (today's Citibank).

Three years later the U.S. had a central bank, after a propaganda campaign using the Big Lie. Americans were told that major bankers—whom they heartily distrusted—were opposed to the Fed. In fact, the Fed was set up to cartelize the banking industry, doing for it what the ICC had done for big railroads and the FTC for other big businesses. Before 1913, market forces prevented any one bank or group of banks from expanding the money supply too egrediously. The Fed changed all that by enabling big banks to inflate together while protecting them from competition.

In its origins and its operations, the Federal Reserve is the most secretive of American political institutions. After his briefings before the first presidential debate with Ronald Reagan in 1984, Walter Mondale exclaimed to his campaign manager: "For the first time I understand the Federal Reserve!"

Like Mondale, a U.S. senator for many years and then vice president, we are told almost nothing about what the Fed does and why. All we hear—from political leaders, bankers, pundits, and kept economists—is that it ensures prosperity and prevents depressions, that its officials know exactly what they're doing, and that no one in his right mind could possibly question its existence.

Like virtually all of the official line, this is the reverse of the truth.

William Greider—one of America's best political reporters—set out to examine all of this in *Secrets of the Temple: How the Federal Reserve Runs the Country* (Simon and Schuster, 1987). But the man who has exposed the charades of government in so many other areas does not do a similar job on the government's great inflation machine.

To his credit, Greider has changed the way journalists think about the Fed. Even his old paper, the *Washington Post*, no longer automatically defers to the central bank, where once it ran its pronouncements as fact. Also to his credit, Greider has angered financiers and bankers by telling the truth: that the Fed is the most powerful policy-making institution in America and maybe the world. (Those who profit from what Andrew Jackson used to call the Monster prefer to continue operating in the dark.)

Greider criticizes the Fed, but for all the wrong reasons. For example, he claims it isn't inflationary enough! And he calls for high, sustained inflation to create prosperity and justice. Inflation will resolve the eternal conflict between the rich and the poor, says Greider, in favor of the poor.

There is a seemingly eternal conflict, but it's between those who use the government to get rich, and the rest of us who are thereby made poorer.

In his chapter on the founding of the Fed, Greider mentions the idea of the Fed as cartel, but he never brings it up again. His own position is that the Fed came about through

popular demand, stimulated by political movements for higher farm prices and an end to bank panics. In fact, these groups provided only a political opportunity and an ideological excuse for the Morgan-Rockefeller forces—in cahoots with the politicians—to seize control of the dollar by establishing the Fed.

Greider claims that deflation, not inflation, benefits bankers, and says that the Fed seeks to promote "the virtual elimination of dollar inflation." But the central bank was established only to circumvent the strictures of the gold standard. That is, it was founded to inflate.

The constituents of Fed Chairman Alan Greenspan are commercial bankers and the government, not depositors or citizens, and the Fed's actions are primarily motivated by the interests of Washington and the big money-center banks.

Inflation benefits the Fed and its constituents as counterfeiting benefits a counterfeiter and his gang. The private counterfeiter, however, is a relatively minor criminal; the Fed does exactly what the counterfeiter does, but massively and on a world-wide scale. As in so many other areas, what is (rightly) condemned in the private sector is lauded in the public.

Greider calls inflation "a promising model for social equity." "Many poor people" benefit since they don't have to bear the rising costs of medical care and housing with "Medicaid and public housing." Similarly, the "elderly" are "partially protected" from inflation because Social Security is "indexed to the inflation rate."

The government, politicians, bureaucrats, banks, government contractors, and other interests profit, since they get the new money first, and can spend it before prices go up, thereby transferring wealth to themselves from the people who get it last.

Average taxpayers are harmed in at least five ways: first, since they receive new Fed money last, they can spend it only after prices have gone up; second, they pay a hidden tax of

currency debasement on their dollar-denominated savings; third, they pay a direct tax for the salaries and perks of the bureaucrats, politicians, and welfare recipients whose incomes are indexed to inflation; fourth, they suffer the consequences of inflation-caused recessions and depressions; and five, they lose some of their liberty, since inflation strengthens the government at the expense of individual freedom.

The poor, despite Greider, are harmed especially. The inflation-fueled growth of government creates more hungry and homeless by decreasing general prosperity and opportunity. Then, only the smart, well-educated, and healthy can get ahead. Those most in need of a charitable helping hand are instead kicked in the teeth by Washington, D.C.

Inflation also increases the costs to the poor of becoming independent from the dole. However, like so many negatives for the people, this is a benefit for the government. By enlarging the dependent class, inflation justifies even more "poverty" programs actually designed to benefit bureaucrats, social workers, Medicaid doctors, D.C. consultants, public housing builders, etc.: the whole welfare industry.

Inflation, by illegitimately transferring wealth to the government-connected, also helps cement present social stratifications in place. The bigger government is, the fewer Horatio Algers there are. People who get to the top through force and fraud prefer it that way.

Inflation can help debtors (by stealing from savers)—one of its great advantages, according to Greider—but it mainly aids the greatest debtor of them all, big government, which is always and everywhere the enemy of the poor.

Then there is the business cycle, which even a little inflation will cause. In the free market, interest rates are determined by consumer preferences for savings over consumption. In the days of a real U.S. gold standard, this meant that corporations could issue 30-year bonds paying 3%.

The Austrian theory of the business cycle, developed by Ludwig von Mises, shows that when the Fed artificially

lowers interest rates by injecting credit into the banking system, it gives businessmen the same signal as if people decided to save more of their incomes. In response, companies invest in processes to produce goods for later purchase by consumers with their larger savings.

But when businessmen seek to market these goods, they find the demand isn't there. Consumers haven't saved enough, and the investments were what Mises called "malinvestments"—those unjustified by real economic conditions. The result is a bust.

Any amount of new Fed money and credit will lead to these malinvestments, despite the claim of Greider (and of Milton Friedman) that recessions only occur when the Fed steps on the brakes. The monetarist notion of increasing the money supply every year by 3-5% "to keep up with GNP" is damaging for this very reason. Only zero inflation will do.

By the way, despite Friedman, there is nothing wrong with the Fed's stopping the flow of money and credit to end the boom, as happened in 1929. The wrong was the inflation that took place during the 1920s, and the Hoover-Roosevelt policies that prevented a recovery for over a decade. The original culprit, of course, was the existence of an institution able to cause all this trouble.

Greider hates deflation, but it is the natural, healthy condition of the market. With the money supply relatively stable under a gold standard and the production of goods and services increasing, the dollar buys more. Prices gently fall (imagine the VCR situation extended to the whole market) and real wages increase. That's what happened to our country in the 19th century, and it brought about the greatest economic growth in history.

Greider, good journalist that he is, does provide compelling accounts of the Fed's Continental Illinois and Mexican debt bailouts, and new evidence that "Arthur Burns . . . deliberately manipulated monetary policy . . . to help re-elect

his old friend Richard Nixon." He quotes Fed Governors admitting that they consciously pursued a monetarist policy from 1979-1982 (something Friedman would like us to forget), shows how "Volcker stared down U.S. Senators and presidential advisers" during the recessions of the early 80s, and tells how the officers of Volcker's old employer, Rockefeller's Chase Manhattan Bank, persuaded him to loosen the money supply.

Greider criticizes the quantity theory of money as a "simple answer to bewildering complexities," and cites money supply statistics from the 1970s and 1980s that use M-1 as a base. But the "money supply" in these years can hardly be summarized by M-1 because of financial deregulation (and the Fed's propensity to keep changing its statistical bases to hide its activities). A much more accurate monetary statistic is the True Money Supply (TMS) constructed at the request of the Mises Institute by Murray Rothbard and Joseph Salerno on Austrian economic principles.

Greider does have one point, however: most economists do oversimplify the quantity theory of money. An increase in the money supply raises relative prices, but what mainstream economists call the "price level" is a fiction. As relative prices increase, different sectors of the economy are affected in different ways. Prices have risen, but far more important, the price structure has changed.

Greider rebukes Congressional Democrats for voting for the deregulation of interest rates in the Monetary Control Act of 1980. This aspect of the bill merely recognized something the market had already accomplished through money market funds. But he glosses over, or does not mention, other important provisions, which: centralized even more power in the Fed, removed all collateral from U.S. notes, enabled the Fed to reduce bank reserve requirements to zero, empowered the president to declare bank holidays, and allowed the Fed to monetize foreign debt (including nearly worthless Third World debt held by the money-center banks). Only Ron Paul,

then a Congressman from Texas, understood what the bill really meant, and waged a courageous and single-handed fight against it.

The Secrets of the Temple serves an important purpose by shining a bright light on an institution for too long hidden in obfuscation and propaganda. But the real secrets of the temple are that: the Federal Reserve is an unconstitutional and illegitimate enterprise; it serves a narrow elite of bankers, government officials, and connected businessmen; it ensures prosperity for these insiders at the expense of the rest of us; it causes economic disasters; its officials are arrogant bumblers; and great statesmen and economists—from Andrew Jackson to Ron Paul, from Ludwig von Mises to Murray N. Rothbard—have wanted it or similar operations wiped from the face of the earth.

A central bank is incompatible with a free society. For the sake of our economy and our liberty, and of simple justice, we should abolish the Monster, and sow salt in the earth where it stood. In its place we need a real gold standard and non-fraudulent free banking, as Ludwig von Mises outlined, and as the Founding Fathers intended.